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ABSTRACT

The Stanley Foundation annually assembles a panel of experts from the public and private sectors to assess specific foreign policy issues and to recommend future direction. The participants in the round-table discussion summarized in this report agreed that the Soviets are moving from a Marxist-Leninist version of socialism to a broader version, and that Gorbachev appears to be ready to bring in a new form of Soviet socialism, in which both the selfless and self-interested urges of people are taken into account. The minimum requirements for this change were identified and the discussion that followed is reported under the following headings: (1) economic aspects of property rights; (2) property relations in a reformed Soviet economy; (3) legal difficulties relating to reform efforts; (4) popular attitudes and related barriers to reform; and (5) policy implications. There exists no model of transition on how to move from a centrally planned economy to a system with aspects of a free market economy. It was agreed that the United States can assist with advice on the institutions of a market economy, on technical expertise, with educational exchanges, and through increased economic relations with the Soviets. The report also includes the keynote address by Richard H. Stanley, in which the conferees were asked to consider two underlying issues in their deliberations: (1) the changing national power relationships, including the relative erosion of U.S. power; and (2) the profound global systemic changes that are rendering old policy assumptions obsolete. (NL)

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Soviet Economic Reform: Socialism and Property

30th Strategy for Peace, US Foreign Policy Conference - 1989

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The Stanley Foundation

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About the Conference

Strategy for Peace, the Stanley Foundation's US foreign policy conference, annually assembles a panel of experts from the public and private sectors to assess specific foreign policy issues and to recommend future direction.

At the October 1989 conference, sixty-nine foreign policy professionals met at Airlie House Conference Center to recommend elements of a strategy for peace in the following areas:

1. Debt and Democracy in Latin America
2. Soviet Economic Reform: Socialism and Property
3. Crisis in China: Prospects for US Policy
4. Global Change and Africa: Implications for US Policy

The work of the conference was carried out in four concurrent round-table discussions. These sessions were informal and off the record. The rapporteurs tried to convey the conclusions of the discussions and the areas of consensus and disagreement. This is the report of one discussion group.

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The rapporteur prepared this report following the conference. It contains her interpretation of the proceedings and is not merely a descriptive, chronological account. Participants neither reviewed nor approved the report. Therefore, it should not be assumed that every participant subscribes to all recommendations, observations, and conclusions.

Soviet Economic Reform: Socialism and Property

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Soviet Economic Reform Discussion Group

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Chair Herbert Levine and Rapporteur April Harding

Soviet Economic Reform: Socialism and Property

In the four years since Mikhail Gorbachev began his efforts to reform the Soviet economy, many startling changes have been implemented, yet more radical ones are expected. While it is, as yet, impossible to see how far these changes will take the Soviets, the direction in which they are heading is becoming visible, as are the many obstacles they face.

Some of the Soviets' greatest hopes for invigorating the economy come from planned changes in property rights. State ownership is now recognized as one of the chief culprits in the system's decline, and it is felt that new forms of ownership will bring about greater efficiency.

The issue of changing property rights inevitably is linked to the concept of socialism, for state ownership has been an integral part of socialism in the Soviet Union. And since the Soviet leadership wishes to remain within the socialist framework, it is necessary that new concepts of socialism be defined.

Property rights and the flexibility of the definition of socialism are integral issues of the reform. Consideration of these issues by conference participants clarified the range of options open to Gorbachev and the constraints under which he operates.

Socialism

Any discussion of Soviet socialism prior to Gorbachev would have focused on the Marxist-Leninist version underlying the Soviet system. This would have included the following: state property, rule of the Communist party, and central planning. However, it must be noted that Marxism-Leninism is only one version of socialism. This fact gains importance as it is realized that the Soviets seem to be moving from this version to a broader version. The struggle over ideological concepts and terminology is directly related to the

discussion on reform and thus holds practical interest. Gorbachev appears ready to bring in a new form of Soviet socialism in which both the selfless and self-interested urges of people are taken into account. Many new economic relationships are being recognized; however, the fact that they will remain a socialist system leads to certain constraints.

Although no consensus was reached by the group as to the appropriate working definition of socialism in this context, the issue of more practical importance, Gorbachev's constraints with respect to socialism, was the topic of a fruitful discussion. Under the heading "minimum elements necessary to stay within socialism" the following requirements were mentioned: (1) no exploitation of man by man, (2) a comprehensive guarantee of social-economic rights, (3) concern for equality, (4) collective ownership, and (5) communal participation in the disposal of resources. Participants supported various combinations of these elements as being necessary for an acceptable new system in the Soviet Union.

Although nonexploitation of labor was generally agreed upon, exactly what would constitute a nonexploitative labor market was the subject of much disagreement.

Economic Aspects of Property Rights

Property rights concern the right to use, alter, and sell property and the right to the income generated by the property. Specified property rights determine the structure of relationships among organizations and individuals in a system. Property rights play an important part in Soviet reforms since they directly affect economic efficiency. Some participants believed that drastically altering property relations is unnecessary. What is required is decentralized decision making which can be achieved through diffusing responsibility. However, previous attempts at increasing productivity in this way proved unsuccessful. In general it was agreed that some version of nonstate property, private or group property, is necessary to bring about efficient behavior.

Two major views of the effects of private property were discussed. The neoclassical view is that through personal interest private property motivates hard work, promotes risk-taking, and

gives incentives for the efficient allocation of resources. The evolutionary view, on the other hand, emphasizes that private property makes an individual's or an organization's success depend on its own ability. Both views embrace the general link between private property and efficiency: Private property brings about efficient behavior by linking personal and social or public interests. This occurs through an owner's personal and direct interest in profits and in the long-run value of his property. Thus the property owner is motivated by the pursuit of both income (profits) and wealth (asset value). Private property is also linked to the hard budget constraint which makes innovation more likely since, in a competitive environment, failure to innovate will decrease profits and eventually bring about bankruptcy.

The reformed property rights will be aimed at a particular problem in the present Soviet system—the lack of a "killing mechanism." Subsidizing inefficient producers at the expense of successful enterprises is a major problem which has persisted through the previous, less-radical reforms beginning in the 1960s. By bringing about decentralization through changing property rights, the Soviets hope to curb this major source of inefficiency.

New property relations will also help to overcome the principal-agent problem. It will decrease the inefficient behavior brought about by the large distance between those people with "owner-like" interest in a firm and those who are in charge of running it.

It is also expected that the new property rights will decrease the amount of decisions made on political bases, making them instead the subject of economic evaluation.

Property Relations in a Reformed Soviet Economy

In deciding what types of property rights to implement, the Soviet leadership is faced with a tradeoff between control and efficiency. Many changes which have occurred already can serve as indicators of the direction in which the Soviets are heading. Among these are the following:

- The Law of the State Enterprise—which dramatically increased the economic independence of the enterprise.
- The Law on Cooperatives—which was the first legalization of private economic activity. It allows for individuals (in groups of

three or more) to form cooperatives for production and for the provision of services. It should be noted that cooperative members are essentially owners who derive income commensurate with their work and with their investment.

- A law on leasing—which allows farmers to lease land. Terms may be very long and leases may be passed on through inheritance, making leasing rather close to owning land.
- Reforms related to the issuing of shares in enterprises (socialist equity). These are only partially developed and thus far include the constraints that shares may not be reorganized or sold.
- The Law on Joint Enterprises—which allows foreign ownership of assets including majority ownership.

Additional reforms being discussed include:

- Changes in rights of public ownership. Various proposals have been made, among them shifting ownership rights to municipalities and regional governments.
- The initiation of corporation laws. A draft in circulation would provide for the creation of joint stock corporations, allowing enterprises to move out of their ministries and form these corporations.
- A comprehensive law on ownership, which is being heatedly debated. Proposals include diffusion of ownership to three levels (federal, republic, and municipal) and ownership of enterprises by labor collectives.
- A law on the ownership of land—with several competing ideas, including ownership by the republics of all land in their territory and coownership between republics and central governments on a contractual basis.

Leasing is promising as a politically viable way of moving from complete state dominance. One advantage is that it avoids the requirement of high initial investment in areas of mechanized production. In the agricultural sector, leasing is particularly likely to be effective. The specifics of allowable leases are especially important. It is necessary that the terms allowed be quite long and that access to capital be provided.

Joint ventures have ideological importance as the initial opening of the Soviet economy as well as practical importance. They are expected to be important means of transforming the Soviet system,

even though the actual number of such enterprises is small. The spillover effects should be influential especially in the areas of management techniques and technology. Some participants believed these effects will be minor. They stressed that Western firms are unlikely to enter the Soviet market due to the prevalent uncertainty and difficulty of repatriating profits.

Legal Difficulties Relating to Reform Efforts

The creation of new property relations within the framework of the old institutions has created certain difficulties. Among these is a strong resentment toward individuals (mainly those in cooperatives) earning what is perceived to be excess profits. In addition, a notable increase in corruption has accompanied the development of the cooperative sector. This increase is directly related to additional problems with the supply sector.

There have been various responses to these difficulties. An amendment to the Law on Cooperatives was recently passed restricting their operations, particularly of "purchase and sale" cooperatives. Discretion over their opening and closing was given to local Soviets, where anti-cooperative feeling is common. The local authorities have also been given power to prohibit certain types of cooperatives and to set prices on staple goods sold by them. State prices will be applied to goods made from inputs bought from the state. This legislation is seen as a response to two problems. The first is the large amount of corruption taking place in the cooperative sector, much of which stems from the lack of an open-supply system. The second issue being addressed is the unfair advantage the cooperatives are seen as possessing. The changes are formulated to place the cooperatives on equal footing with the state enterprises.

This legislation is perceived as a compromise between the leadership's desires to support the cooperative movement and to placate the general populace that resents the cooperatives.

Many other problems are becoming apparent with the passage of time and with additional legislation. To grant rights it is obviously necessary to alter the environment so that people can actually exercise these rights. For instance, an enterprise completely

dependent on its ministry for supplies and investment funds is unlikely to take its minister to court over excessive state orders. Some participants mentioned arbitration courts as institutional bodies which might serve to increase enterprises exercising their rights. These courts are administrative tribunals which hear cases regarding economic disputes between social units, contract enforcement, Soviet economic law, and economic expedience. They have thus far failed to increase the likelihood of the enterprises asserting their rights because they generally favor administrative agencies. More needs to be done to protect the newly endowed rights of individuals and enterprises.

The system of new property rights must be seen as stable to have the desired effect on behavior. Thus far this is not the case. This issue is a manifestation of the basic Soviet concept of rights. The Soviets view rights as delegated as opposed to sovereign—individuals and enterprises are being given conditional privileges rather than vested rights. These are not stable entitlements and, as mentioned above, are less defensible in court. Naturally, this has a direct effect on people's behavior. Enterprises are less likely to object to bureaucratic interference, and individuals are less likely to take risks.

A successful reform must bring about a new legal culture. This includes a system of judicial defense of property, independent courts, and judges not predisposed against the ownership of property. An entire psychology of adjudication must be developed. Both the institutional framework and an ideological commitment are necessary for people and organizations to feel secure in their new rights. They must also expect this commitment to continue so that they will behave appropriately in accordance with the new rights and pursue long-run economic goals.

Popular Attitudes and Related Barriers to Reform

Abroad, Gorbachev is lauded for his efforts to turn the Soviet economy around. However, at home there is increasing opposition to the reforms being implemented. Empirical evidence from Hungary and a study based on interviews with Soviet emigres illustrated deep-seated support for the ideas underlying socialism including state ownership of industry (but not agriculture). The irony is that efforts to build socialism have been unsuccessful while the

accompanying socialization was successful and is now working against them.

More specifically there is notable opposition to cooperatives, which are seen by many people as receiving unearned income. In addition, there are numerous opponents of legislation that would allow individual ownership of the means of production.

There was disagreement among conference participants as to the importance of these attitudes on political actions. Some felt that in the Soviet political system, Gorbachev still enjoys immense power, and popular opinion is of little concern. Supporting this view is evidence of a high degree of direct influence by the party leadership on the Supreme Soviet. It was pointed out that elected officials have not achieved anywhere near the amount of influence held by their Western counterparts. On the other side, there is daily evidence in many newspapers and magazines of the growing influence of constituencies with common interests. Regardless of the magnitude of the direct effect of attitudes and popular opinions, it was agreed that the effectiveness of reforms could certainly be limited by them. The leadership must take this into account so that only realistic laws will be passed—ones that are realistic given the current situation and attitudes, since compliance is necessary and is directly affected by attitudes. Evidence in the Soviet Union suggests that public opinion has a greater effect at the local level.

It was pointed out that the strength of the opposition is likely to be exaggerated since supporters of the changes occurring are likely to be less vocal.

Policy Implications

This final issue focusing on policy implications of the events taking place in the Soviet Union was the most practical of the group's discussions. There was a general consensus that the United States should help the reform process, but there was disagreement on how far it should go in this.

Encouraging investment in the Soviet Union by US multinational corporations was suggested as a viable way to aidthe reform process. This could be done by accelerating the renegotiation of

tax laws, since the present laws discourage investment and working in the Soviet Union.

Education is seen as a potentially important area in which the United States can assist. However, the form of this assistance was not agreed upon. There is a question of what would be useful knowledge for Soviet businessmen and managers. It is also appropriate that both scholars and specialists give advice on the functioning of a market economy and how to deal with the problems of moving toward such a system.

Technical assistance should be lent by both the private sector and government agencies. This includes a conscious effort to increase communication and exchanges between governmental and scholarly organizations.

Changing the structure of trade between the United States and the Soviet Union could have a strong impact, as well as using US influence in international organizations to encourage their assistance and improve their position towards the Soviet Union. Accepting the Soviets into the General Agreement on Trade and Tariffs was suggested as a positive move.

Conclusion

Gorbachev's goal of restructuring the economic system is made more difficult by the fact that he is essentially flying blind. There is no model of transition of how to move from a centrally planned economy to a system with many aspects of a free market economy. His efforts are also hampered by the inherent inertia of a system. Even as he implements radical changes, he is frustrated by the lack of response to them. In order for people's behavior to change there must be the expectation that the changes are permanent and real. The Soviet people must believe that these new rights actually exist and will not be changed tomorrow. Positive popular feelings regarding this program's success as well as the passage of time will contribute to stability. The United States can assist with valuable advice both on the institutions of a market economy and on technical matters, with educational exchanges, and with increased economic relations with the Soviets.

President's Address

by Richard H. Stanley
President, The Stanley Foundation

Richard Stanley opened the Strategy for Peace Conference with the following remarks, addressing all participants from the four topic groups.

For the past thirty years this conference series has been dedicated to the development of US policy. This year is no different. However, we all know that the context of policy formulation, whether direct as in the case of our group on China, or indirect as with our group on Soviet economic reform, has altered significantly as the world and our relative position in it have changed fundamentally over the past three decades. This simple observation prompts me to ask you to consider in your deliberations two larger, underlying issues that will define the context for US policy: first, the changing national power relationships including the relative erosion of US power since our immediate post-World War II period of dominance; and second, the profound global systemic changes that are rendering old policy assumptions and formulas obsolete.

Let me elaborate. First, with regard to the relative decline of US power, I think the facts are clear while interpretations may vary. For example, we are all well aware that in the space of a few years the United States has gone from being the world's largest creditor nation to being the world's largest debtor nation as we continue to import capital to offset our decline in world markets. Our trade and budget deficits exceed $100 billion annually which is also a relatively new phenomenon, at least in terms of the size of the deficits. In another area of national power we remain the world's preeminent military power, but we are finding that military strength, a continuing necessity for the present and foreseeable future, has brought on obligations and problems that outstrip our means, a dilemma Paul Kennedy has labeled "imperial overstretch." Additionally, we, as well as the Soviets, have learned hard lessons about the limits of military power. We have finally realized that the absolute power of strategic weapons makes their use unthinkable. The two superpowers are like hulking giants who dare not unleash their might, thus rendering these massive arsenals nearly impotent in terms of enforcing political decisions.

Both have learned hard lessons about the limitations of superior conventional forces in Viet Nam and Afghanistan respectively and are now beginning to understand the Pandora effect of conventional weapons proliferation in the Third World.

These economic and military trends have been a blast of cold reality and have caused some to make alarmist predictions about the decline of US power and the disaster awaiting the US economy. Others have chosen to deny the trends, relying instead on nationalist sentiment and a retrenchment of old policies from the glory days of US dominance. Before following either path, or any in between, I hope we will first be willing to make a sober assessment of the degree and nature of decline and how it relates to a broader global adjustment toward a more multipolar world.

Second, and just as obvious as the altered status of US dominance, is the fundamental change occurring in the nature of the world. This change is evident in the form of globalization of both problems and systems. For example, the economic system has been internationalized as nonstate economic actors such as transnational corporations and major financial institutions have grown in size and power. This change has greatly curtailed the ability of national governments to independently manage their own economic futures.

The environment illustrates the globalization of a problem. The global dimensions of this issue have only recently surfaced. Thirty years ago we knew little about pollution and treated it as a local problem. Today the environmental crisis threatens the very ecosystem that sustains life on this planet. Clearly, the greenhouse effect, depletion of the ozone layer, ocean pollution, deforestation, and desertification are among several examples of truly global and basic problems that defy traditional state-oriented solutions.

While our conference topics were never intended to be related in any way, they are all linked by these overriding issues that I believe will help form the basic context for the formulation of US policy.

Our discussion on "Global Change and Africa: Implications for US Policy" acknowledges the need to deal with these issues in its

title as well as in its objectives. Fundamental changes in the international system have significantly altered the context within which US policy toward Africa will be formulated and implemented. This discussion group will build on the growing awareness of these developments and of their impact in Africa in an effort to develop guidelines for effective multilateral initiatives there.

The group examining "Soviet Economic Reform: Socialism and Property" will seek to go straight to the heart of the Soviet effort to respond to its own decline in power and its effort to continue as a great power through economic and political reform. The Soviets must attempt these efforts in an evolving international context. They have been our major rival and the motivation for much of our foreign policy for some forty years. They will continue to be of major concern for the foreseeable future, but the importance of the rivalry is declining. The Soviets are clearly in a less advantageous position than the United States to meet these new challenges. However, you can be sure that the success or failure of their efforts will have significant implications for US policy.

Those of you here to investigate the relationship between "Debt and Democracy in Latin America" are no doubt well aware of the interplay of state and nonstate economic actors in this region. It is my belief that Latin America will be of profound importance to the future of US political-economic policy. This region, that has seen so many years of US domination, will no doubt hold many lessons for the United States as we adapt to new political and economic relationships.

Finally, the discussion group on the "Crisis in China: Prospects for US Policy" offers a fascinating opportunity to examine our own response to the situation in China as well as to the actual events taking place there now. Are economic sanctions and political threats effective or desirable methods in face of the recent aberrant behavior of the Chinese government? What is the appropriate role for the US, and what are its duties and obligations? How effective can we be? Do we need to develop new methods to achieve our objectives?

I should say at this point that I am not trying to paint a particularly negative picture of the future, but I believe change is under-

way and its continuation is inevitable. Therefore, my plea to you is to look to the future and to the new global realities as you develop policy criteria. Perhaps Paul Kennedy sums up all this best in his book, *The Rise and Fall of the Great Powers*, in the following passages:

> The task facing American statesmen over the next decades, therefore, is to recognize that broad trends are underway, and there is a need to "manage" affairs so that the relative erosion of the United States' position takes place slowly and smoothly, and is not accelerated by policies which bring merely short-term advantage but longer-term disadvantage. ...
>
> In all of the discussions about the erosion of American leadership, it needs to be repeated again and again that the decline referred to is relative not absolute, and is therefore perfectly natural; and that the only serious threat to the real interest of the United States can come from a failure to adjust sensibly to the newer world order.

Having laid out these challenges and having asked that you give them some consideration, I feel obligated to share with you some early thoughts on how we might respond. First, I think that we are looking for ways to proceed and not for grand theories or solutions to impose. Simply put, I think the best approach would be process-oriented.

One of the more immediate responses I would recommend is elimination of the increasingly false dichotomy separating foreign and domestic policy. Can we any longer have a domestic environmental policy and a foreign version? Surely the debt problem in Latin America has domestic implications. Iowa farmers are well aware of the domestic impact that Soviet economic and agricultural reforms can produce. Drug policy is another example of the blurring of foreign and domestic issues. And with the growing public interest and formation of politically active groups concerned with China, domestic implications will soon be felt.

The joining of foreign and domestic policy is closely related to a second pressing need: better coordination of national policy. All too often foreign nations get one word from Treasury and another from State. We have different national agendas that only serve to send mixed signals and exacerbate problems. What are the priorities of our policy toward Latin America? It depends on whom you

talk to—the banks want their money and the State Department wants democracy. I don't believe these issues are antithetical, but the prospects for both might be improved through better coordination of policy. It almost goes without saying that greater consideration must be given to multilateral options in meeting the problems and challenges that lie ahead. As I have already noted, by their very nature, the internationalization of the economy and the planetary threats to the environment defy any unilateral or bilateral attempt at resolution. Add to this the growing level of poverty, overpopulation, international health problems, as well as nontraditional threats to security like terrorism and drugs, and the need for greater consideration of multilateral alternatives is mandatory. It is time to build the international institutions needed to assist in meeting these problems.

Perhaps the most difficult and profound adjustment is the rethinking of our view of ourselves in the world. I recently chaired an international conference on the environment. During discussion of sustainable development, a concept of development that is environmentally sound and regenerating, one of our participants from a developing country stated bluntly that sustainable development will not be possible until the people of the developed world enter into a solidarity pact with the people of developing countries that acknowledges that all our lives are equally important. I do not mean to sound some simplistic call for us to raise our level of consciousness to do right and be good. Rather, I want to underscore the fact that we have yet to learn to think of ourselves as part of a global system. We have not acknowledged or internalized our interdependence with the people or the planet. The United States is a great nation that has proven time and again its resourcefulness, its intelligence, and its courage to meet new challenges—we must now add maturity and wisdom to meet the challenges ahead.

I look forward with great anticipation to your stimulating discussions. I trust that they will prove productive and creative and that together we may make a modest contribution toward a secure peace with freedom and justice.

The Stanley Foundation

Activities

The Stanley Foundation works toward the goal of a secure peace with freedom and justice by encouraging study, research, and discussion of international issues. Programs strive to enhance individual awareness and commitment and to affect public policy.

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Related Publications

Soviet Integration Into the World Economy. A uniquely diverse group considered obstacles and opportunities associated with Gorbachev's internal and international economic reforms. October 1988, 16pp.

Implications of the New Soviet Foreign Policy. 1987 Strategy for Peace conference report, 64pp. (contains three other conference reports).

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